

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petitions	:	
of	:	
M & B APPLIANCE, INC. AND	:	DETERMINATION
MAN M. MUNJAL AND INDER S. BINDRA,	:	DTA NOS. 807626,
AS OFFICERS	:	807628 and 807631
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period September 1, 1983	:	
through February 28, 1987.	:	

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Petitioners, M & B Appliance, Inc. and Man M. Munjal and Inder S. Bindra, as officers, 83-15 Broadway, Elmhurst, New York 11373, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1983 through February 28, 1987.

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on September 17, 1990 at 1:15 P.M., with all briefs to be submitted by February 15, 1991. Petitioners filed a brief on December 18, 1990 and the Division of Taxation filed a brief on February 11, 1991. Petitioners appeared by John R. Serpico, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Andrew S. Haber, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation made a proper request for the books and records of M & B Appliance, Inc. and, if so, whether such request was made for all periods in issue.

II. Whether the Division of Taxation properly determined that the books and records of M & B Appliance, Inc. were inadequate to permit a detailed audit to be conducted thereby justifying the employment of a test period audit to determine additional taxable sales.

III. Whether, based upon the test period audit method employed, the Division of Taxation properly determined additional sales and use taxes due from M & B Appliance, Inc. and from

Man M. Munjal and Inder S. Bindra, as officers thereof.

### FINDINGS OF FACT

On December 18, 1987, the Division of Taxation ("Division") issued identical notices of determination and demands for payment of sales and use taxes due to petitioners, M & B Appliance, Inc. ("M & B") and Man M. Munjal and Inder S. Bindra, as officers of M & B, assessing sales tax due in the amount of \$46,192.50, plus penalty and interest, for a total amount due of \$77,990.49 for the period September 1, 1983 through February 28, 1987.

Petitioner M & B, by one of its officers or appointed representatives, executed two consents which, by virtue thereof, extended the period of limitation on assessment for the period September 1, 1983 through August 31, 1984 to anytime on or before December 20, 1987.

On July 7, 1986, the auditor sent a letter to M & B advising such petitioner that a field examination of its books and records would be conducted on July 25, 1986. This letter stated, in pertinent part, as follows:

"All books and records pertaining to your Sales Tax liability for the period under audit should be available. This would include journals, ledgers, Sales invoices, purchase invoices, cash register tapes, exemption certificates and all Sales Tax records. Additional information may be required during the course of the audit."

The period under audit, as set forth in the letter, was September 1, 1983 through May 31, 1986. During the course of the audit, the auditor met with M & B's accountant, Ramesh Sarva, C.P.A. The auditor states that he made oral requests to Mr. Sarva for books and records of M & B for the remaining period at issue herein, i.e., June 1, 1986 through February 28, 1987. At the hearing, Mr. Sarva testified that he did not recall whether or not the auditor had requested books and records for the period after May 31, 1986.

During the period at issue, M & B was in the business of selling appliances, both at wholesale and retail. Petitioner Inder S. Bindra was the president and a shareholder of M & B, while petitioner Man M. Munjal was the vice-president and was also a shareholder. Neither of these petitioners disputes the Division's contention that each, as an officer, was personally liable for the collection of sales and use taxes due from M & B pursuant to the provisions of Tax Law §§ 1131(1) and 1133(a).

The following books and records were made available to the auditor by M & B: sales tax returns and related worksheets; Federal income tax returns; sales workpapers; some sales invoices (test period); a printout of the general ledger; and some resale certificates and other exemption certificates. Upon his examination of sales invoices, the auditor found that such invoices were not in numerical order and that some invoices contained no number at all. Based upon the foregoing, the auditor determined that M & B's books and records were not complete and, therefore, that a detailed audit could not be conducted.

The auditor compared M & B's gross sales per the general ledger printout to gross sales per Federal income tax returns and sales tax returns and found gross sales figures to be in substantial agreement. As a result, M & B's gross sales were accepted as filed.

The auditor thereupon decided to utilize a test period audit method to determine whether or not M & B's claimed nontaxable sales were properly substantiated by resale certificates, shipping documents and other exemption documents. The period selected by the auditor was December 1, 1984 through February 28, 1985. It was the testimony of the auditor that M & B's accountant, Mr. Sarva, stated that it would be too difficult and time consuming to assemble and produce invoices for the entire audit period and that he, therefore, asked the auditor to do a test period analysis. In addition, the auditor testified that Mr. Sarva did not object to the test period selected.

For the test quarter selected, M & B claimed nontaxable sales in the amount of \$586,348.00. Upon the auditor's review of available invoices and exemption documents, he determined that M & B was unable to substantiate claimed nontaxable sales totalling \$52,424.00, or 8.94 percent thereof. He then applied this percentage to claimed nontaxable sales for each quarter during the audit period, totalling \$6,262,962.00, which resulted in disallowed nontaxable sales in the amount of \$559,909.00 with resulting tax due (at the statutory rate of 8¼ percent) of \$46,192.50.

On December 14, 1988 and again on June 22, 1989, conciliation conferences were held by the Bureau of Conciliation and Mediation Services ("BCMS"). At the second conciliation

conference, additional documentation substantiating claimed nontaxable sales was produced.

Based upon such documentation, the following adjustments to the assessment were made:

(a) Upon his examination of invoices for the test quarter, the auditor found that alleged sales for resale had been made by M & B to ABC Electronics World ("ABC"), the payment to M & B having been made by ABC using individual credit cards from ABC's retail customers. For the test quarter, such sales totalled \$26,660.33. M & B's attorney, Mr. Serpico, claimed that these sales occurred only during the Christmas season and substantiated this claim through the presentation of documentation. As a result thereof, the conferee determined that the auditor's original calculation, which, utilizing his test period analysis, factored in the \$26,660.33 for each quarter, should be modified to subject the \$26,660.33 to tax for only one quarter per year.

(b) Based upon documentation presented at the conference, additional nontaxable sales were allowed for the test quarter which, along with the recalculation resulting from the credit card sales referred to above, resulted in the unreported taxable percentage being reduced from 8.94 percent (as originally determined upon audit) to 2.945 percent. The revised percentage was determined as follows:

Gross sales (QE 2/85)	\$714,148
Allowed nontaxable sales (revised)	557,112
Taxable sales (incl. sales tax)	157,036
Adjusted taxable sales (excl. sales tax)	145,068
Reported taxable sales	127,800
Unreported taxable	17,268
% Unreported Taxable (unreported taxable divided by claimed nontaxable [\$586,348])	0.02945

By applying this revised percentage to reported nontaxable sales for each of the sales tax quarters at issue, additional tax due was reduced from \$46,192.50 to \$21,815.09, plus applicable penalties and interest.

At the hearing, M & B offered 26 invoices for sales made during the test quarter all of which, it maintains, should have been allowed as nontaxable sales. The testimony of M & B's accountant, Ramesh Sarva, was that these invoices were obtained and furnished to M & B's attorney for presentation at the conciliation conference. Said attorney, Mr. Serpico, testified

that the conferee allowed some, but not all, of these invoices in recomputing M & B's allowed nontaxable sales from \$519,056.00 (as determined by the auditor) to \$557,112.00. An examination of the Conciliation Order, the Report of Tax Conference and documents attached thereto does not disclose which of these 26 invoices were allowed and which were not.

#### SUMMARY OF THE PARTIES' POSITIONS

Petitioners' position may be summarized as follows:

(a) M & B maintained complete books and records which were never examined by the auditor and, as a result thereof, resort to a test period audit method was improper.

(b) M & B contends that the assessment should not extend beyond the quarter ended May 31, 1986 since the error percentage was applied to the period June 1, 1986 through February 28, 1987 without requesting and/or examining petitioners' books and records for this period.

(c) M & B objects to the inclusion of the credit card sales (\$26,660.33) since it maintains that all such sales were, in fact, sales for resale. As indicated in Finding of Fact "7", supra, all of these transactions which are at issue involve sales from M & B to ABC for which M & B received payment from the credit cards of ABC's customers. Petitioner Man M. Munjal and M & B's accountant, Mr. Sarva, testified that ABC, because of bad credit ratings with various banks, could not accept credit cards from its customers, i.e., it did not have a merchant number which a vendor fills in on the credit card invoice and submits to the particular bank in order to receive payment. As a result, M & B agreed to accept from ABC, as payment for merchandise sold by M & B to ABC, credit card slips from ABC's customers. Mr. Munjal stated that ABC guaranteed payment and that, if the bank refused to pay M & B for one reason or another, ABC would pay M & B directly. It should be noted that Mr. Munjal and Mr. Sarva stated that the credit card invoices from ABC's customers were used to pay ABC's outstanding liabilities to M & B for merchandise which M & B sold to ABC. However, both stated that the credit card was not necessarily used by the customer to purchase merchandise which ABC had purchased

from M & B, but could have been for anything in ABC's inventory. Moreover, since ABC included sales tax on the invoice to the customer, the credit card invoice accepted by M & B and submitted by it to the bank also included sales tax. M & B maintains, however, that the sales tax collection and payment was the responsibility of ABC since it was making the actual retail sale and that the full amount of the credit card invoice merely was applied to ABC's outstanding liability owed to M & B.

The Division of Taxation's position is as follows:

(a) M & B's books and records were incomplete (see, Finding of Fact "5") so a detailed audit could not be performed. A test period audit method was, therefore, justified. M & B's accountant agreed to the test period audit and to the period utilized in such audit.

(b) While the initial appointment letter sought records only for the period September 1, 1983 through May 31, 1986, an oral request for the remaining periods at issue was made to M & B's accountant during the pendency of the audit.

(c) M & B has failed to prove, by clear and convincing evidence, that it did not make sales to customers procured by ABC and accept such customers' credit cards in payment therefor. The Division contends that petitioners failed to adequately prove that such sales were sales for resale.

#### CONCLUSIONS OF LAW

A. Tax Law § 1138(a)(1) provides, in part, that if a return required to be filed is incorrect or insufficient, the amount of tax due shall be determined on the basis of such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices. The resort to external indices is predicated upon a finding of insufficiency in the taxpayer's record keeping such that verification of sales is a virtual impossibility (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44). In such circumstances, the Division of Taxation must select a method of audit reasonably calculated to reflect tax due (Matter of Grecian Square v. State Tax Commn., 119 AD2d 948), and the burden

is on petitioner to establish by clear and convincing evidence that both the method used to arrive at the tax assessment and the assessment itself are erroneous (Matter of Sol Wahba, Inc. v. State Tax Commn., 127 AD2d 943).

To determine the adequacy of a taxpayer's records, the Division of Taxation must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, lv denied 71 NY2d 806; Matter of King Crab Restaurant v. State Tax Commn., 134 AD2d 51). The purpose of this examination is to determine whether the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commn., supra; Matter of Ronnie's Suburban Inn, Inc., Tax Appeals Tribunal, May 11, 1989).

Based upon the records presented, it is hereby determined that the failure of M & B to provide complete records in an auditable form, i.e., complete invoices which were dated and/or numbered to permit verification of reported sales for the entire audit period, warranted the resort to external indices. The Division cannot be required to rely on unverifiable records (see, Matter of Vebol Edibles v. State of New York Tax Appeals Tribunal, 162 AD2d 765, 557 NYS2d 678, lv denied 77 NY2d 803, 567 NYS2d 643; Matter of Club Marakesh v. Tax Commn. of State of New York, 151 AD2d 908, 542 NYS2d 881, lv denied 74 NY2d 616, 550 NYS2d 276). In addition, it is hereby found that the auditor properly requested M & B's books and records for the period beyond those covered in the initial appointment letter, i.e., June 1, 1986 through February 28, 1987. It must be noted that the auditor, based upon his comparison of gross sales per the general ledger printout to Federal income tax returns and sales tax returns, accepted M & B's gross sales as reported. The only matters remaining in dispute concerned claimed exempt sales.

B. With respect to the audit of M & B's claimed exempt sales, petitioners claim that all invoices were produced, but that some were disallowed for "unwarranted reasons". Both in his audit report and in his testimony at the hearing, the auditor provided reasonable justification for

his disallowance of some of the claimed exempt sales. Petitioners were given ample opportunity to substantiate some of such sales and did, in fact, do so (as evidenced by the reduction in the assessment at the conciliation conference).

Petitioners strenuously object to the use of a test period method as employed by the auditor. Admittedly (see, page 15 of petitioners' memorandum of law), the employment of such method was acceptable at the time of the audit. However, when the resulting assessment was unacceptable, petitioners contended that a detailed audit should have been performed. Petitioners cannot have it both ways, i.e., they cannot consent to the type of audit method employed and then rescind that consent based solely upon the amount of the resulting assessment without proving, by clear and convincing evidence, that both the method employed and the assessment itself were erroneous (Matter of Sol Wahba, Inc. v. State Tax Commn., supra).

Petitioners have not produced any evidence to show that the use of a test period audit was not reasonably calculated to reflect tax due (they actually consented to such method) nor have they shown, assuming that the method was not improper, that the test period selected was unreasonable. Petitioners have attempted to prove that certain sales to ABC for which payment was made with the credit cards of ABC's customers should not be included as taxable sales and, in addition, petitioners have produced invoices and alleged exemption documents which they contend substantiate additional nontaxable sales for the test quarter. Each of these contentions will be addressed separately.

C. The audit report indicates that M & B's accountant, Mr. Sarva, stated to the auditor that, while sales tax was not separately stated on the sales invoices from M & B to ABC, the tax was included in the price. It must be noted that the sales prices on nearly all of these invoices were odd amounts such as \$292.27, \$442.74, \$583.63, etc. Clearly, if tax had been included, there could be no contention that these sales for which M & B accepted the credit cards from ABC's customers were sales for resale.

In the advocate's comments on the conciliation conference, Mr. Saleh (who performed



this audit), refers to these sales as sales for resale. In the report, he states that the attorney (petitioners' attorney, Mr. Serpico) agreed that the vendor (M & B) is liable for the tax on these sales, but that the practice of accepting credit cards from ABC's customers occurred only during the Christmas season, a fact which Mr. Serpico apparently proved to both the auditor and the conferee (as evidenced by the taxing of such transactions only during one quarter per year).

At the hearing, however, petitioners explained these sales were sales for resale for which M & B accepted, as payment on account, the credit cards of various ABC customers (see, paragraph "9[c]"). No resale certificates have been presented herein. No testimony, affidavits or any other type of evidence was presented from ABC (or any of its principals or employees) or from any of the ultimate customers (the credit card holders) which would substantiate petitioners' contentions. Without such supporting evidence petitioners' testimony offered at hearing cannot be found credible. Based upon the absence of such evidence and differing explanations offered at various stages of these proceedings by petitioners and their representatives, it is hereby found and determined that, other than the conferee's determination that such sales should be included as taxable sales for only one quarter for each of the years at issue, petitioners are entitled to no further adjustment for these credit card sales.

D. As indicated in Finding of Fact "8", supra, petitioners produced 26 invoices relating to sales made during the test quarter which they claim were nontaxable sales for which they were not given credit by the auditor or the conciliation conferee.

At the conference, allowed nontaxable sales were increased by the conferee from \$519,056.00 (as allowed by the auditor) to \$557,112.00. Excluding the credit card sales, it can be calculated that the conferee allowed, as additional nontaxable sales, the additional amount of \$11,396.00 for the test quarter ( $\$557,112.00 - \$26,660.00 = \$530,452.00 - \$519,056.00 = \$11,396.00$ ). Admittedly, these 26 invoices were produced by petitioners at the conciliation conference. After a careful review of each of the 26 invoices and the exemption documents in support thereof, it is hereby determined that petitioners should have been allowed nontaxable sales (from these invoices) in the amount of \$19,941.00. This allowance (18 of the 26 invoices

were found to be nontaxable) is based upon properly documented bills of lading, exempt organization certificates and certificates of diplomatic and consular tax exemption.

Since it cannot be determined, with any degree of certainty, which of the invoices were allowed by the conferee, nontaxable sales must be increased by \$8,545.00 (\$19,941.00 - \$11,396.00) to \$565,657.00. The result of this adjustment is to further decrease the unreported taxable percentage as follows:

Gross sales (QE 2/85)	\$714,148
Allowed nontaxable sales	565,657
Taxable sales (incl. tax)	148,491
Adjusted taxable sales (excl. tax)	137,174
Reported taxable	127,800
Additional taxable sales	9,374
% unreported taxable	0.015987
(\$586,348 claimed nontaxable sales divided by \$9,374 additional taxable sales = 0.015987)	

Petitioners reported, for the audit period, nontaxable sales totalling \$6,262,962.00. Applying this revised unreported taxable percentage (0.015987) results in unreported taxable sales of \$100,126.00. Adding to the credit card sales for three quarters (3 x \$26,660) of \$79,980.00 results in total unreported sales of \$180,106.00 with tax due thereon (at 8¼ percent) in the sum of \$14,859.00. The total assessment due and owing from each of the petitioners is hereby reduced to \$14,859.00, plus penalty and interest.

E. The petitions of M & B Appliance Inc. and Man M. Munjal and Inder S. Bindra, as officers, are granted to the extent indicated in Finding of Fact "7" and Conclusion of Law "D", supra; the Division of Taxation is hereby directed to modify the notices of determination and demands for payment of sales and use taxes due issued to such petitioners on December 18, 1987 accordingly; and, except as so granted, the petitions are in all other respects denied.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE